Board of Mgrs. of 111 Hudson St. Condominium v 111 Hudson St., LLC
2015 NY Slip Op 31452(U)
July 28, 2015
Supreme Court, New York County
Docket Number: 651959/2014
Judge: Anil C. Singh

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 45

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THE BOARD OF MANAGERS OF 111 HUDSON STREET CONDOMINIUM,

Plaintiff,

-against-

111 HUDSON STREET, LLC, CHRISTINA MARCH SCHUITEMAKER, PETER MOORE, GIORA MANOR, TRIPLE ONE REALTY, L.L.C., MARK ANG, JOSEPH DALE DUMBACHER, JOHN DAVID DUMBACHER, SETHURAMAN PRAKASH, VANDANA SHETH, DANIELLE RICH AND 111 HUDSON STORE LLC,

Defendants.

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DECISION AND ORDER

Index No. 651959/2014

Mot. Seq. 002-010

HON. ANIL C. SINGH, J.:

In this action for breach of contract, fraud, breach of fiduciary duty, and negligence, 111 Hudson Street, LLC., ("Sponsor"), and its members ("Member defendants") move for an order pursuant to CPLR 3211(a)(7), dismissing The Board of Managers Of 111 Hudson Street Condominium's ("Board of Managers") complaint. The Board of Managers opposes the motion.

FACTS

The first cause of action is for breach of the Sponsor's contractual obligations to establish a reserve fund in the amounts required under the Offering Plan for the building located at 111 Hudson Street, New York, New York ("Condominium"). The building was converted to condominium ownership in 2008 ("Conversion"). Pursuant to the Operating Agreement that established the Sponsor ("Operating Agreement"), a percentage interest in the Sponsor, referred to as a Sharing Ratio ("Sharing Ratio"), was assigned to each of its members ("Sponsor members"). The complaint alleges that on June 27, 2008, the Sponsor's Second Amendment of the Offering Plan, declaring the plan effective, was filed and accepted by the Attorney General.

Under the Offering Plan, the Sponsor was required to establish a reserve fund within thirty days after the first unit closing, which occurred on July 2, 2008. Thus, the deadline to establish the reserve fund was August 1, 2008. The Board of Managers alleges that the Sponsor and Sponsor Members are liable to the plaintiff in the amount of $403,991.03, which represents the difference between the amount of the reserve fund that the Sponsor was required to establish and the actual reserve fund established by the Sponsor, together with interest on such amount from August 1, 2008.

The second cause of action is for fraud in relation to the Sponsor's alleged failure to disclose the damaged condition of the cellar and sub-cellar in the Offering Plan. In the Offering Plan, the Sponsor claimed to have "no knowledge of any material defects or need for major repairs to the Property," except as described in the Offering Plan's section titled, "Description of Property and Specification of Building Conditions." The complaint alleges that in 2010 or 2011, the non-Sponsor members of the Board of Managers became aware of an engineering report prepared on June 6, 2008 by the ISLA Engineering Service Company ("ISLA Report") at the request of one Sponsor member, Joseph Dumbacher. The ISLA Report found that activities of 111 Hudson Store LLC ("111 Hudson Store") on the first floor resulted in water damage in the sub-cellar of the Condominium, which created a "serious structural problem," and recommended structural repairs and the immediate installation of shoring. The Second Amendment of the Offering Plan, filed after the ISLA report, failed to mention this problem. The plaintiff alleges that the amount of related damages is believed to be in excess of $2,500,000.

The third cause of action is for breach of the Sponsor's contractual obligations under the Offering Plan to cause the Board of Managers to maintain the property in "substantially the same condition and manner as on the date of presentation" until the Sponsor no longer controlled the

Board of Managers. The Sponsor had control over the Board of Managers until approximately the fall of 2009, when non-Sponsor related unit owners assumed majority control. According to the defendants, the current Board of Managers, consisting of non-Sponsor unit owners Faiza Patel and Marco Depero, who did not purchase their units directly from the Sponsor, and Member defendant Sethuraman Prakash, was elected on March 31, 2011. The complaint alleges that while in control of the Board of Managers and fully aware of the deteriorating and decaying structure of the cellar and sub-cellar of the building, the Sponsor failed to take any steps to remedy these conditions from further deteriorating. The plaintiff alleges that the amount of related damages is believed to be in excess of $2,500,000.

The fourth cause of action is against the Member defendants who have served on the Board of Manager for the alleged breach of their fiduciary duty owed to the unit owners of the Condominium. The plaintiff alleges upon information and belief that defendants Schuitemaker, Prakash, Ang, Manor and possibly other defendants served on the Board of Managers. The complaint alleges that these defendants breached their fiduciary duty owed to the unit owners by failing to cause the Condominium to (a) make necessary repairs to the cellar and sub-cellar of the Building and thereby allowing the damaged condition of the cellar and sub-cellar to further deteriorate, (b) require that the owner of the Commercial Unit make repairs to the cellar of the Building and cause its tenant to cease occupying the premises in a negligent manner that was resulting in further structural damage to the building, and (c) to ensure that as Sponsor and Member defendants' units were sold, the reserve fund would be funded and established in accordance with the Sponsor's contractual and statutory obligations. The plaintiff alleges that the amount of related damages is believed to be in excess of $2,500,000.

The fifth cause of action is against 111 Hudson Store for breach of its contractual obligations under the By-Laws of the Condominium ("By-Laws"). As a commercial unit owner of the Condominium, 111 Hudson Store is contractually obligated to comply with the By-Laws. Under the By-Laws, "[e]ach Unit Owner shall be responsible for all damages to any and all other Units and/or Common Elements" caused by "the negligence, misuse or neglect of the owners of such Unit or his, her or its tenants, invitees, employees, agents or contractors." According to the ISLA Report, 111 Hudson Store has caused the aforementioned structural damage by continuously causing water to leak through the cellar floor into the sub-cellar of the Condominium. The complaint alleges that 111 Hudson Store has failed to adequately maintain and repair the cellar of the Condominium, and through the negligence, misuse and neglect of its tenant, which 111 Hudson store has permitted and condoned, has caused damage to common elements of the Condominium. The plaintiff alleges that the amount of related damages is believed to be in excess of $2,500,000.

The sixth cause of action is against 111 Hudson Store for negligence. The complaint alleges that the aforementioned structural damage to the cellar and sub-cellar of the Condominium was the proximate cause of the negligence of 111 Hudson Store, or its tenant for whose negligent conduct 111 Hudson Store is responsible. The plaintiff alleges that the amount of related damages is believed to be in excess of $2,500,000.

The seventh cause of action is against 111 Hudson Store for attorneys' fees. According to the By-Laws, "all costs and expenses (including reasonable attorney's fees and disbursements) incurred, in connection with any breach of...these By-Laws...shall be paid immediately upon demand...by the Unit Owner committing the breach or violation to the Board of Managers." The

complaint alleges that 111 Hudson Store is liable for the attorneys' fees and disbursements incurred by the plaintiff in connection with this action, in amount to be determined by the Court.

On June 26, 2014, a request for a special meeting and a notice of the special meeting were sent to each of the three members of the Board. The notice of the special meeting stated that a meeting would be held on July 1, 2014 for the purpose of voting to proceed with and ratify the commencement of this action. The action was commenced on June 27, 2014, but without authorization by the Board of Managers at that time. On July 1, 2014, all three members of the Board, as well as the Board's counsel, attended the special meeting, which was held via conference call. At that meeting, a majority of the Board of Managers voted to ratify the commencement of the action. Patel and Depero voted in favor of the commencing the action, and Prakash abstained. The minutes of the meeting were then distributed to all of the Board members and approved at the Board's subsequent meeting on September 18, 2014, which was attended by all three Board members.

PLEADING STANDARD

On a motion to dismiss for failure to state a cause of action, the court accepts all factual allegations pleaded in plaintiff's complaint as true, and gives plaintiff the benefit of every favorable inference. (CPLR 3211(a)(7); Sheila C. v Povich, 11 AD3d 120 [1st Dept 2004]). The court must determine whether "from the [complaint's] four corners[,] 'factual allegations are discerned which taken together manifest any cause of action cognizable at law." (Gorelik v. Mount Sinai Hosp. Ctr., 19 AD3d 319 [1st Dept 2005]) (quoting Guggenheimer v. Ginzburg, 43 NY2d 268, 275 [1977]). Vague and conclusory allegations are not sufficient to sustain a cause of action. (Fowler v. American Lawyer Media, Inc., 306 AD2d 113 [1st Dept 2003]).

MARTIN ACT

The Martin Act ("Act"), New York's blue sky law, expansively prohibits fraudulent and deceitful practices in the sale of securities. (General Business Law 352, 353 [McKinney]). Under the Act, the New York Attorney General has broad regulatory and remedial powers to investigate possible securities fraud, and to commence civil or criminal prosecutions (CPC Intern. Inc. v McKesson Corp., 70 NY2d 268, 277 [1987]). There is no express or implied private right of action under the Martin Act (Id. at 276; see also State v 7040 Colonial Rd. Assoc. Co., 176 Misc 2d 367, 368 [Sup Ct 1998]) ("No private right of action exists under the Martin Act"). Courts have dismissed state law claims "within the purview" of the Act because permitting them to proceed would functionally allow private claims under the Act. (Marcus v Frome, 329 F Supp 2d 464, 468 [SDNY 2004]).

In order to bring a valid private claim that is not preempted by the Act, a plaintiff must "bring a common-law claim (for fraud or otherwise) that is not entirely dependent on the Martin Act for its viability." (Assured Guar. (UK) Ltd. v J.P. Morgan Inv. Mgt. Inc., 18 NY3d 341, 353 [2011]). The complaint must illustrate "active concealment unrelated to alleged omissions from Martin Act disclosures." (Board of Managers of 374 Manhattan Ave. Condominium v. Harlem Infil LLC, 2010 WL 2572583, at *7 (N.Y.Sup.)). Examples of active concealment are painting over drywall to disguise the discovery of water damage, or putting up a wall to hide leaking pipes or holes in the foundation. (Kerusa Co. LLC v W10Z/515 Real Estate Ltd. Partnership, 12 NY3d 236, 246 [2009]).

The Attorney General's Rules and Regulations, authorized under the Martin Act, require condominium offering plans to include a comprehensive description of the condition of the property and building, including any "defective condition which is hazardous or which requires immediate repair to prevent further deterioration." (13 NYCRR 23.7). In Kerusa, the sponsor

stated in amendments to the offering plan that there were no "material changes of facts or circumstances affecting the property or the offering." (Id. at 245). The plaintiff claimed that despite the sponsor's knowledge of major defects that arose during construction, the sponsor did not disclose the construction and design defects in the offering plan amendments. (Id. at 245). The Court of Appeals held that "a purchaser of a condominium apartment may not bring a claim for common-law fraud against the building's sponsor when the fraud is predicated solely on alleged material omissions from the offering plan amendments mandated by the Martin Act (General Business Law art 23-A) and the Attorney General's implementing regulations (13 NYCRR part 20)." Id. at 239. Kerusa's fraud claim was "too intertwined" with the Martin Act's disclosure requirements to be sustained. Id. at 241.

Here, in its complaint, the Board of Managers allege that the Sponsor's Second Amendment of the Offering Plan failed to mention a serious structural problem that it had knowledge of, despite its statement in the Offering Plan that it had no such knowledge of any material defects or need for major repairs. The Sponsor and Member defendants argue that the Martin Act preempts this fraud claim because it is based solely on material omissions from the Offering Plan Amendments mandated by the Martin Act and the Attorney General's regulations. The court agrees.

The facts alleged by the Board of Managers fit entirely within the purview of the Martin Act, preempting any private right of action. The Board of Managers' fraud claim is based entirely on omissions from the "Description of Property and Specification or Building Conditions" section of the Offering Plan, a required disclosure under the Attorney General's Rules and Regulations, authorized under the Act. (13 NYCRR 23.7). Further, no allegations of

active concealment are alleged unrelated to omissions from Martin Act disclosures. The fraud claim is preempted by the Act, and the motion to dismiss the fraud claim is granted.

In the alternative, the motion to dismiss the fraud claim is granted as the statute of limitations bars the fraud claim. The statute of limitations for fraud is the later of six years from the date the cause of action accrued, or two years from the time the plaintiff discovered or should have discovered the fraud. (Civil Practice Law and Rules 213). A cause of action for fraud begins on the acceptance date of a misleading offering plan or its last filed amendment. (see Bd. of Managers of Chelsea Quarter Condo. v. 129 W. Residential Partners LLC, 14 Misc 3d 1212(A) [Sup Ct 2007]).

The Second Amendment to the Offering Plan was accepted on June 27, 2008. The Board of Managers allegedly discovered the fraud in 2010 or 2011. Thus, the latest date the action could be commenced was 6 years after June 27, 2008. The action was commenced on June 27, 2014, but without proper authorization by the Board of Managers. On July 1, 2014, the Board of Managers ratified the action at a special meeting, but board ratification does not relate back for the purposes of the statute of limitations. (see Fed. Election Comm'n v. NRA Political Victory Fund, 513 US 88, 89, 115 S Ct 537, 538, 130 L Ed 2d 439 [1994]) ("The Solicitor General's 'after-the-fact' authorization does not relate back to the date of the FEC's unauthorized filing so as to make it timely"). The second cause of action for fraud is dismissed because it is time barred.

STANDING

The defendants contend that the Board of Managers lacks capacity and standing to bring this case. A Board of Managers of a condominium, like a corporation, must comply with appropriate corporate governance (see Bd. of Managers of Clermont Greene Condominium v

Vanderbilt Mansions, LLC, 44 Misc 3d 1205(A) [Sup Ct 2014]) (dismissing action due to the board's failure to comply with corporate governance). Defendants assert that plaintiff lacks capacity to bring the action, as it was never properly authorized by the Board of Managers. Plaintiff responds, although the Board of Managers did not authorize the action before it was filed on June 27, 2014, the Board of Managers met on July 1, 2014 and ratified the filing. Plaintiff argues that ratification successfully cured the initial defect of the commencement of this action (see Skytrack Condo. Bd. of Managers v. Windberk Partners, 167 AD2d 381 [2d Dept 1990]) ("assuming the [Condominium's] initial Board of Managers was improperly constituted, as the appellants contend, [the Court] nevertheless finds that the board's decision to commence the action, arguably voidable, was ratified by the subsequent acts...by a properly constituted Board of Managers"). Similarly, here the Board of Managers ratifies this action at the special meeting held on July 1, 2014.

Further challenging the Board of Managers' standing, the defendants suggest that since Depero and Patel are subsequent purchasers who bought their units from sellers other than the Sponsor, they are not in contractual privity with the Sponsor and cannot sue to enforce contractual rights against the Sponsor or its members. (See e.g. ComJet Aviation Mgt. v. Avition Invs. Holdings, 303 AD2d 272, 273 [1st Dept 2003]) (only parties in contractual privity may enforce the terms of a contract).

The only plaintiff is the Condominium's Board of Managers, suing on behalf of all unit owners. New York's Condominium Act authorizes a condominium's Board of Managers to bring actions "in its discretion, on behalf of two or more of the unit owners...with respect to any cause of action relating to the common elements or more than one unit." (Real Property Law §339-dd). The causes of action are brought on behalf of more than two unit owners relating to

the reserve fund, which affects all units, and the sub-cellar of the Condominium, which is a common element. The reserve fund is required by law "to be used exclusively for making capital repairs, replacements and improvements necessary for the health and safety of the residents of such buildings," which affects all unit owners of the building. (Unconsolidated Law § 26-703 [McKinney]). New York Real Property Law § 339-e defines "common elements" to include "the basements [and] cellars." Therefore, the Board of Managers has authority to bring this action under New York law. The defendants' challenge to the Board of Managers' capacity and standing fails.

RESERVE FUND

Sponsor Entity

Plaintiff alleges that the Sponsor breached the Operating Agreement by failing to fund the Condominium's reserve fund through each Sponsor member's Sharing Ratio of this financial obligation. An operating agreement is the governing instrument of an LLC. (N.Y. Limited Liability Company Law §417). Members of the LLC and a "third party beneficiary" may enforce its terms. (NY Jur. Contracts §235; see also State of Cal. Pub. Employee's Retirement Sys. v. Shearman & Sterling, 95 NY2d 427, 431 [2000]). The defendants argue that the plaintiff is neither a member of the LLC, nor an intended beneficiary of the Operating Agreement, and cannot enforce its terms. (PT. Bank Mizuho Indonesia v PT. Indah Kiat Pulp & Paper Corp., 25 AD3d 470, 471 [1st Dept 2006]). The explicit language of the Operating Agreement precludes liabilities to third-party beneficiaries.

Nonetheless, plaintiff's breach of contract claim is based on the Offering Plan, not the Operating Agreement. "An Offering Plan is a contract between the Sponsor and unit purchaser." (511 West 232nd Owners Corp. v. Jennifer Realty Co., 285 AD2d 244, 247 [1st Dept 2001] affd in part, 98 NY2d 144 [2002]). As the Board of Managers is representing all unit owners, it

clearly has the right to enforce the contractual terms of the Offering Plan. The Sponsor's motion to dismiss plaintiff's cause of action for breach of contract to establish a reserve fund is denied.

Sponsor Members

Plaintiff also asserts a breach of contract claim relating to the reserve fund against the Sponsor members for their failure to fund the Condominium's reserve fund. It is established law in New York that members of a limited liability company (LLC) are not personally liable for the obligations or liabilities of the LLC. (Limited Liability Company Law §609; see also Retropolis, Inc. v. 14th Street Development, LLC, 17 AD3d 209, 211 [1st Dept 2005]; Pomerance v McGrath, 124 AD3d 481, 482 [1st Dept 2015] lv to appeal dismissed, 25 NY3d 1038 [2015]) ("participation in a breach of contract will typically not give rise to individual director liability").

In addition, §3.09 of the Operating Agreement unambiguously eliminates liability of the Member defendants "for the debts, obligations or liabilities of the Company, except to the extent required under the [Limited Liability Company Act] with respect to amounts distributed to the Member at a time when the Company was insolvent or rendered insolvent by virtue of the distribution." The court holds that no breach of contract claim can be maintained against the Member defendants and their motion to dismiss is granted.[1]

MAINTENANCE BREACH

Plaintiff asserts that the Sponsor breached its contractual obligations in the Offering Plan as a result of water damage in the Condominium's sub-cellar. The Sponsor argues that Plaintiff's "supporting allegations are vague, conclusory and indefinite, and further fail to particularize the manner in which the Sponsor allegedly breached its contract." CPLR Section

[1] In his brief, plaintiff implies that the Conversion is a fraudulent conveyance because the Sponsor distributed its assets to individual members and rendered the Sponsor insolvent, and therefore members of the Sponsor should be held liable. Since plaintiff did not explicitly raise a claim of fraudulent conveyance in its complaint, the court will not address this argument.

3013 states, "statements in a pleading shall be sufficiently particular to give the court and parties notice of the transactions or series of transactions or occurrences intended to be proved, and the material elements of each cause of action or defense." The elements of a claim for breach of contract include the existence of a valid contract, plaintiff's performance of its obligations thereunder, defendant's breach and resulting damages. (See Morris v 702 E. Fifth St. HDFC, 46 AD3d 478, 479 [1st Dept 2007]). A breach of contract claim must particularize the manner in which the defendant allegedly breached its contract with plaintiff. (See Murphy v Sheldon, 13 Misc 3d 1223(A) [Sup Ct 2006]).

Plaintiff alleges that the Offering Plan requires the Sponsor to "cause the Board of Managers to maintain the property in substantially the same condition as on the date of presentation until the Sponsor no longer controls the Board of Managers," and explains that the Sponsor breached this provision by failing to take any steps to remedy the water damage conditions or to prevent these conditions from further damaging the Condominium. The court holds that Plaintiff has alleged the material elements of his breach of contract claim with sufficient particularity. The Sponsor's motion to dismiss plaintiff's cause of action for breach of contract to maintain the property is denied.

BREACH OF FIDUCIARY DUTY

Plaintiff asserts a breach of fiduciary duty claim against several Member defendants who have served on the Board of Managers after the Conversion for failing to repair the property and to cause the Sponsor to fund the reserve fund. Defendants move to dismiss this claim on the ground of the statute of limitations.

New York law does not provide a single statute of limitations for breach of fiduciary duty. Rather, the applicable limitations period depends on the substantive remedy

sought. Where the remedy sought is purely monetary in nature, courts construe the suit as alleging "injury to property" within the meaning of CPLR 214(4), which has a three-year limitations period. Where the relief sought is equitable in nature, the six-year limitations period of CPLR 213(1) applies. (See IDT Corp. v Morgan Stanley Dean Witter & Co., 12 NY3d 132, 138 [2009]). As the Plaintiff seeks only monetary damages, the statute of limitations is three years. According to the defendants, the current Board of Managers, consisting of non-Sponsor unit owners Patel and Depero, and Member defendant Prakash, was elected on March 31, 2011. The last date the plaintiff could bring this action was March 31, 2014, but this action was commenced on June 27, 2014. Therefore, plaintiff's breach of fiduciary duty claim against the Member defendants is time-barred.

Additionally, "to hold an individual board member liable, the complaint must specifically plead independent tortious acts." (Grubin v Gotham Condominium, 34 Misc 3d 1202(A) [Sup Ct 2011]) (internal quotation omitted). In Grubin, the court dismissed allegations against all individual board members but Burke and Back, who had both lied to the plaintiffs in person. Id. Here, the only wrongful acts plaintiff alleges against the Sponsor members are failures to carry out the Board of Managers' contractual obligations. Absent any individual and separate tortious conduct committed in bad faith against the plaintiff, a breach of fiduciary duty claim against individual Sponsor members cannot be maintained.

Accordingly it is,

ORDERED that the Sponsor's motion to dismiss the first cause of action for breach of contract to establish a reserve fund is denied.

ORDERED that the Member defendants' motion to dismiss the first cause of action for breach of contract is granted.

ORDERED that defendants' motion to dismiss the second cause of action for fraud is granted; it is further

ORDERED that defendants' motion to dismiss the third cause of action for breach of contract to maintain the property is denied; it is further

ORDERED that defendants' motion to dismiss the fourth cause of action for breach of fiduciary duty is granted; it is further

ORDERED that the remaining defendants shall answer the complaint within 30 days of today; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 218, 60 Centre Street, on September 10, 2015, at 10:00 AM.

Date: July 28, 2015
New York, New York

Anil C. Singh